

## Message Text

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INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

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FM AMEMBASSY LIMA

TO SECSTATE WASHDC 5460

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 4700

EO 11652: GDS

TAGS: EINV, ECON, BDIS, PFOR, PE

SUBJECT: DRAFT LAW ON INDUSTRIAL COMMUNITY PUBLISHED -  
STRENGTHENS WORKERS ROLE IN COMPANY MANAGEMENT  
AND CUTS OUT LOOPHOLES

REFS: (A) LIMA 4473; (B) LIMA 6024 OF 7/23/74

1. SUMMARY: AFTER CONSIDERABLE DISCUSSION WITHIN GOP COUNCILS, GOP FINALLY PUBLISHED ON MAY 31 LONG-AWAITED DRAFT DECREE LAW WHICH WOULD EFFECT BASIC CHANGES IN INDUSTRIAL COMMUNITY LEGISLATION. CHANGES WOULD GREATLY STRENGTHEN HAND OF INDUSTRIAL COMMUNITY REPRESENTATIVES ON BOARDS OF DIRECTORS OF COMPANIES, ALLOWING THEM EFFECTIVE VETO OVER MANAGEMENT DECISIONS THROUGH APPEALS PROCEDURE TO A GOP-DOMINATED COURT. IT WOULD ALSO ELIMINATE ABILITY OF COMPANIES TO SIPHON OFF EARNINGS INTO COMMERCIAL BRANCHES OR SUBSIDIES, THEREBY AVOIDING CASH AND EQUITY PAYMENTS TO WORKERS. DRAFT LAW DID NOT INCLUDE TWO DRACONIAN FEATURES OF A FIRST DRAFT, UN-OFFICIALLY CIRCULATED LAST YEAR (SEE REF B), WHICH WOULD HAVE ESTABLISHED A CENTRAL FUND INTO WHICH MORE PROFITABLE COMPANIES WOULD HAVE BEEN REQUIRED TO PAY FIXED AMOUNTS, SO THAT THE INDUSTRIAL COMMUNITIES' LESS PROFITABLE CONCERNS

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COULD BUY SHARES IN THEIR COMPANIES. IN ADDITION, FIRST

DRAFT ALSO CONTAINED PROVISION THAT 5 PERCENT OF COMPANIES' SHARES MUST BE SOLD TO COMMUNITIES EACH YEAR TO "GUARANTEE" COMMUNITY REACHING 50 PERCENT LEVEL WITHIN FINITE TIME PERIOD.

2. IF THE DRAFT CHANGES ARE FINALLY INCORPORATED IN THE DECREE LAW, WHICH IS OPEN TO PUBLIC SUGGESTIONS FOR A SIXTY-DAY PERIOD, THIS WILL GREATLY INCREASE THE ABILITY OF BOTH WORKERS AND GOVERNMENT TO INFLUENCE PRIVATE INDUSTRIAL COMPANIES' MANAGEMENT DECISIONS. LOCAL BUSINESSMEN, WHILE RELIEVED TO NOTE THAT MANDATORY PURCHASE FEATURE HAS BEEN DROPPED, ARE CONCERNED THAT DIRECT INVOLVEMENT OF SLOW-MOVING PERUVIAN BUREAUCRATIC APPARATUS IN DECIDING COMMUNITY APPEALS COULD SEVERELY CRIPPLE COMPANIES' ABILITY TO MAKE RAPID AND RATIONAL MANAGEMENT DECISIONS. FROM GOP POINT OF VIEW, CHANGES SUGGEST MILITARY LEADERSHIP IS MOVING SLOWLY BUT SURELY WITH WHAT MANY CONSIDER ITS UTOPIAN SCHEME TO BRING ABOUT GREATER DIRECT WORKER PARTICIPATION IN INDUSTRIAL ENTERPRISES. NEVERTHELESS, DRAFT LAW HAS ALREADY BEEN CRITICIZED BY SOME SECTORS OF LABOR MOVEMENT AS FALLING SHORT OF DESIRED WORKER CONTROL OF ENTERPRISES. GOVERNMENT ROLE IN APPEALS PROCEDURE WILL, HOWEVER, AFFORD IT GREATER SCOPE FOR INFLUENCING CORPORATE DECISIONS IN KEEPING WITH GENERAL WAGE AND PRICE POLICIES. END SUMMARY.

3. DRAFT LAW'S INTRODUCTION NOTES THAT THE INDUSTRIAL COMMUNITY (IC) HAS BEEN CREATED TO PROTECT THE RIGHTS OF WORKERS AND THAT CHANGES ARE PROPOSED TO "PERFECT" ITS OPERATIONS. PRINCIPAL CHANGES FOLLOW, WITH COMMENTARY AS APPROPRIATE:

A. COMPOSITION AND POWERS OF IC - IC MUST INCLUDE ALL WORKERS, INCLUDING TEMPORARY WORKERS. (NOTE: CRITICISM HAS BEEN LEVELED AT IC FOR EXCLUDING TEMPORARY WORKERS, ALTHOUGH UNDER DRAFT THEY WILL NOT BE ALLOWED TO HOLD ELECTIVE POSITIONS ON IC COUNCIL NOR SERVE ON COMPANY BOARD OF DIRECTORS.) IC MUST BE ESTABLISHED IN EACH INDUSTRIAL COMPANY WITHIN SIXTY DAYS AND INCLUDE ALL WORKERS IN SUBSIDIARIES, BRANCHES, OR AGENCIES OF THE

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COMPANY. IC CAN INVEST IN THREE WAYS, EITHER IN ITS OWN COMPANY TO MAINTAIN ITS PERCENTAGE OF SHARES IN THE COMPANY WHEN CAPITAL STOCK IS INCREASED, IN COFIDE BONDS, OR IN SECURITIES OF NATIONAL SOCIAL PROPERTY FUND. (NOTE: SOME COMPANIES HAVE BEEN LAX IN SETTING UP IC'S AND LAW SETS FORTH STIFF PENALTIES FOR FAILURE TO DO SO. SOCIAL PROPERTY FEATURE IS NEW, SINCE ORIGINAL SOCIAL PROPERTY LAW DOES NOT CONTEMPLATE INVOLVEMENT BY IC.

PRESUMABLY PURCHASE OF SOCIAL PROPERTY SECURITIES WOULD OCCUR AFTER WORKERS HAVE REACHED LIMIT OF 50-PERCENT OWNERSHIP.)

B. MANDATORY MEETINGS - BOARDS OF DIRECTORS ARE REQUIRED TO MEET TWICE A MONTH AND ALL DISCUSSIONS MUST BE IN SPANISH. (NOTE: BUSINESSMEN BELIEVE THIS FEATURE WILL CAUSE CONSIDERABLE ADMINISTRATIVE PROBLEMS SINCE MANY MEMBERS OF BOARDS OF DIRECTORS, PARTICULARLY LAWYERS, SERVE ON SEVERAL BOARDS AND WOULD SPEND MUCH OF THEIR TIME AT SUCH MEETINGS. SPANISH LANGUAGE REQUIREMENT INCLUDED FOLLOWING RECENT CONTROVERSY WHEN ONE FOREIGN MANAGER INSISTED ON SPEAKING ENGLISH.) FURTHER, ANY COMMITTEE APPOINTED BY BOARDS OF DIRECTORS MUST HAVE CI REPRESENTATION. (NOTE: THIS AVOIDS POSSIBILITY THAT "REAL" POLICY DECISIONS COULD BE MADE WITHOUT PRESENCE OF IC REPRESENTATIVE.) THERE MUST ALSO BE MANAGEMENT MEETINGS WITH ALL THE WORKERS AT LEAST ONCE A MONTH. MEETINGS MUST BE ON COMPANY TIME. (NOTE: BUSINESSMEN FEAR THAT ALL THESE REQUIREMENTS WILL RESULT IN TIME-CONSUMING MEETINGS AND REDUCE OVERALL PRODUCTIVITY OF THEIR ENTERPRISES.)

C. MANAGEMENT'S DECISION -MAKING POWERS REDUCED - IC REPRESENTATIVES "MUST HAVE ACCESS" TO ALL COMPANY INFORMATION. INFORMATION CONCERNING TECHNOLOGICAL PROCEDURES OF A STRICTLY CONFIDENTIAL CHARACTER IS EXCEPTED. AND IC REPRESENTATIVES CAN BE SANCTIONED BY CRIMINAL PENALTIES FOR UNAUTHORIZED USE OF SUCH INFORMATION. (NOTE: THIS STRENGTHENS HAND OF IC ACROSS-THE-BOARD IN MANAGEMENT DECISIONS. HOWEVER, GOP APPARENTLY REALIZES NEGATIVE IMPACT OF THIS FEATURE AND HAS THEREFORE INCLUDED LANGUAGE FOR THE PROTECTION OF TECHNOLOGICAL INFORMATION. THE RECENT LEAKING OF MARCONA'S NEGOTIATING POSITION TO THE PRESS BY A MINING COMMUNITY REPRESENTATIVE IS A CASE CONFIDENTIAL

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IN POINT OF HOW THE IC COULD USE INSIDE INFORMATION FOR ITS OWN PURPOSES AGAINST A COMPANY'S INTERESTS.) BOARDS OF DIRECTORS CANNOT DELEGATE TO MANAGEMENT DECISIONS CONCERNING HIRING, SERVICE CONTRACTS, SALES, CHANGES, RENTS, OR USE OF COMPANY PROPERTY. IC REPRESENTATIVES CAN OBJECT TO SUCH ACTS AND CAN CARRY THEIR APPEAL, IN WRITING, TO THE NEWLY-ESTABLISHED "FUERO" (COURT) OF THE INDUSTRIAL COMMUNITIES. (NOTE: THIS APPEALS PROCEDURE IS PROBABLY THE MOST WORRISOME FEATURE OF THE LAW TO LOCAL BUSINESS COMMUNITY. SINCE MANY BUSINESSES HAVE TO MAKE RAPID DECISIONS, APPEALS PROCEDURE COULD, IN PRACTICE, GREATLY REDUCE THEIR FLEXIBILITY AND STRETCH OUT THEIR REACTION TIME. SINCE GOP WILL, IN EFFECT, CONTROL DECISIONS OF THE IC COURT, IT ALSO GIVES GOP POTENTIAL POWER TO CONTROL TO A GREATER DEGREE THAN HERETOFORE SPECIFIC MANAGEMENT DECISIONS OF

COMPANIES. IT SHOULD NOT BE ASSUMED THAT THE COURT WILL  
IN ALL CASES DECIDE IN FAVOR OF WORKERS, HOWEVER, SINCE  
GOP MAY WISH TO USE THIS MECHANISM AS PART OF ITS EMERGING  
WAGE AND PRICE POLICY.

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C O N F I D E N T I A L SECTION 2 OF 2 LIMA 4700

D. BALANCE SHEETS, USE OF NET INCOME AND CAPITAL  
STOCK INCREASES - BALANCE SHEETS OF COMPANIES MUST BE  
PUBLISHED 15 DAYS BEFORE CONSIDERATION BY BOARDS OF  
DIRECTORS, AND IC REPRESENTATIVE CAN OBJECT. IF HIS  
OBJECTION IS SUSTAINED BY THE IC COURT, THE COMPANY  
MUST MODIFY ITS BALANCE SHEET IN ACCORDANCE WITH THE  
IC COURT DECISION. AMOUNT OF EACH COMPANY'S ANNUAL  
15 PERCENT OF NET INCOME REMITTED TO THE WORKERS TO BUY  
SHARES CAN BE USED AS PART OF THE COMPANY'S WORKING  
CAPITAL OR TO AMORTIZE DEBTS. (NOTE: THIS LAST FEATURE  
IS VIEWED FAVORABLY BY SOME BUSINESSMEN, SINCE IT ALLOWS  
DISCRETIONARY USE OF MONEY WHICH IS OTHERWISE ILLIQUID.)

E. COMMERCIAL ACTIVITIES - IF COMMERCIAL ACTIVITIES  
ACCOUNT FOR 50 PERCENT OR LESS OF GROSS INCOME OF THE  
COMPANY, THEN THE COMPANY MUST CONSOLIDATE ITS ACCOUNTS.  
IN THIS CASE, ALL WORKERS EMPLOYED IN COMMERCIAL ACTIVITIES  
WILL BECOME MEMBERS OF THE IC. IF THE INDUSTRIAL COMPANY  
OBTAINS MORE THAN 50 PERCENT OF ITS GROSS INCOME FROM  
COMMERCIAL ACTIVITIES, IT THEN MUST ESTABLISH A SEPARATE

COMMERCIAL COMPANY WITHIN 180 DAYS OF THE FINAL PROMULGATION OF THE D.L., WITHOUT "PREJUDICING THE INTERESTS OF THE INDUSTRIAL COMPANY OR THE RIGHTS OF THE IC. " IF THIS SEPARATION DOES NOT TAKE PLACE, THEN IT MUST ESTABLISH A CONFIDENTIAL

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SINGLE BALANCE SHEET, AS FOR COMPANIES WITH LESS THAN 50 PERCENT GROSS INCOME FROM COMMERCIAL ACTIVITIES. (NOTE: THESE CHANGES STRIKE AT THE HEART OF THE RELATIVELY EFFECTIVE RUSE MANY COMPANIES HAVE USED OVER THE YEARS TO AVOID PAYING OUT SHARES TO THE IC, BY SETTING UP A SEPARATE COMMERCIAL COMPANY INTO WHICH INCOME IS CHanneLED. SINCE COMMERCIAL ACTIVITIES HAVE NOT BEEN COVERED BY THE INDUSTRIAL COMMUNITY SYSTEM, THIS MECHANISM HAS BEEN ONE MEANS BY WHICH ACQUISITION OF SHARES BY THE IC COULD BE REDUCED. (NOTE: AN INTERNATIONAL MANAGEMENTCONSULTANT TELLS US THAT IN INDIVIDUAL CASES IT WILL BE EXTREMELY DIFFICULT TO DEFINE WITH PRECISION WHAT CONSITUATES COMMERCIAL AS OPPOSED TO INDUSTRIAL ACTIVITIES. HOWEVER, LOCAL BUSINESSMEN HAVE NOT REFLECTED UNDUE CONCERN ABOUT THIS PROVISION AS YET.)

4. COMMENT: THE FOREGOING SHOULD BE READ IN CONJUNCTION WITH REFERENCE A AND EARLIER REPORTING IN 1971-72 WHICH SPELLED OUT IN DETAIL HOW THE IC, AS ORIGINALLY ESTABLISHED, HAD BEEN FUNCTIONING. IF THE EXAMPLE OF THE DRAFT SOCIAL PROPERTY LAW IS FOLLOWED, IT IS POSSIBLE THAT THE DRAFT COULD UNDERGO SEVERAL IMPORTANT MODIFICATIONS, ALTHOUGH IT IS SAFE TO ASSUME THAT THE OVERALL THRUST WILL PROBABLY NOT BE CHANGED DRASTICALLY, SINCE THE LAW HAS ALREADY RECEIVED CONSIDERABLE MASSAGING FROM THE GOP (AND SOME PRIVATE SECTOR ADVISORS WHO, WEUNDERSTAND, OBJECTED TO THE STRENGTHENDED ROLE OF THE IC REPRESENTATIVES, WITHOUT SUCCESS). AS NOTED IN REFERENCE A, THIS LAW WILL DO LITTLE TO IMPROVE THE ALREADY DEPRESSED PRIVATE INVESTMENT CLIMATE. IN THIS REGARD, ECHOING THE ANTI-MARKET VIEWS PREVALENT IN THE NATIONAL PLANNING INSTITUTE,ITS VICE DIRECTOR RECENTLY TOLD EMBASSY OFFICERS THAT THE CHANGES OF THE DRAFT LAW ARE A "COLD-BLOODED STEP" TOWARD FURTHER REDUCING PRIVATE INVESTMENT'S OPTIONS. WHEN QUESTIONED ABOUT ITS EFFECT ON THE OVERALL INVESTMENT CLIMATE,THE VICE DIRECTOR BLANDLY REMARKED THAT, SINCE PRIVATE INVESTMENT HAS NOW BEEN REDUCED BY THE GOP TO 20 PERCENT OF TOTAL INVESTMENT, THE INVESTMENT CLIMATE IS NO LONGER OF IMPORTANCE TO PERU. THIS VIEW IS PROBABLY WIDELY SHARED BY GOP PLANNERS AND OTHER "SOCIAL ENGINEERS" BUT NOT NECESSARILY BY ALL TOP-LEVEL GO LEADERS. IN FACT, CONFIDENTIAL

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THE LATTER'S CONCERN OVER THE INVESTMENT CLIMATE MAY BE  
REFLECTED BY THE DROPPING OF THE FORCED BUY-OUT PROCEDURES  
OF THE EARLIER DRAFT. THEY PROBABLY TEND TO PERCEIVE  
CHANGES AS NECESSARY TO IMPROVE THE PRIVATE SECTOR'S  
PERFORMANCE, SOCIALLY AS WELL AS ECONOMICALLY, FOLLOWING  
THE GUIDELINES OF PLAN INCA WHICH PROVIDES A PLACE FOR A  
"REFORMED PRIVATE SECTOR" WITHIN A PLURALISTIC ECONOMY.  
DEAN

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## Message Attributes

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